



Go Fish in Your Own Pond: Encroachment and Liability to fellow Franchisees

It goes without saying that you should know, and honor, contractual obligations to your franchisor. As a franchise owner, you already know that breaches of your Franchise Agreement can lead to the receipt of default notices, penalties, termination of your franchise, and/or liability to your franchisor for monetary damages. If you violate your Agreement's "exclusive territory" obligations by encroaching on someone else's territory, however, you could face an entirely separate problem: liability to your fellow franchisees. In fact, you might be found liable even if your franchisor failed to stop those activities – and even if you were unaware that your activities amounted to encroachment. These are some of the lessons of *Ford v. Middleton*, Case No. CAL08-01849 (Circuit Court for Montgomery County Maryland), a case in which my firm represented victims of encroachment.

The Fords and the Middletons owned respective "Comfort Keepers" in-home care franchises. In the form Franchise Agreement that each couple signed with franchisor Comfort Keepers Franchising, Inc. ("CKFI"), the franchisee was granted a specific geographical territory – denoted by multiple zip codes – in which no other Comfort Keepers franchisee would be permitted to operate (an "exclusive territory"). In fact, Comfort Keepers promised in each Agreement that it would not "authorize any other franchisee or licensee to provide service to clients within the [applicable] Exclusive Territory nor itself serve clients within the Exclusive Territory." Further, on two (2) different occasions during the Fords' franchise term, CKFI granted the Fords a temporary enlargement of their exclusive territory to encompass additional zip codes.

At the same time, CKFI expressly forbade each couple to do business in someone *e/se's* exclusive territory. Each Franchise Agreement contained the following language:

You may operate outside your Exclusive Territory only with Comfort Keepers' written consent. Comfort Keepers' consent will be granted upon the following conditions . . .

- (a) The area in which you wish to provide service to clients is not

included in another franchisee's territory or in a region currently served by a company-owned Office. . . .

The Fords, whom I represented, alleged in their pleadings that the Middletons had engaged in unauthorized activities in the Fords' "original" exclusive territory and in the "enlarged" territories during the respective "enlargement" periods. Indeed, we contended, the Middletons' operations in the Fords' territories were extensive and had yielded them significant income. Accordingly, the Fords asserted counts for breach of contract and "wrongful interference with economic relations" – an "intentional tort" claim recognized by the Maryland courts. (Your state might or might not recognize a claim for "wrongful interference with economic relations, which differs from the better known claim of "tortious interference with contract." Claims for breach of contract, on the other hand, are universally recognized. For that reason, anyone whose franchisor grants exclusive territories should become aware of what happened in this case.)

At this point, it would be logical to ask the following question: "If the Fords entered into a contract *with CKFI*, and the Middletons entered into a *separate* contract *with CKFI*, how could the Fords sue the *Middletons* for breach of contract?" The answer is that, by relying on the "third party beneficiary" doctrine, we were able to sue the Middletons for breaching their contract with CKFI.

According to our theory, CKFI's contractual provision prohibiting the Middletons from operating in the exclusive territories of other Comfort Keepers franchisees was intended to benefit those other franchisees – including the Fords. (To help explain the context of the prohibition, we pointed out that CKFI promised in the *Fords'* Franchise Agreement that it would not allow encroachment in the Fords' exclusive territory.) Pursuant to the third party beneficiary doctrine, we argued, the non-signatories for whose benefit the Middletons' contractual clause was entered into had the right to sue for breach of that clause – even if the franchisor failed to do so.

At trial, we presented evidence that the Middletons, without first seeking CKFI's written consent as required their Franchise Agreement, had conducted business in the Fords' various exclusive territories. Unable to dispute those facts, the Middletons relied on several different arguments in an effort to justify or excuse their conduct. Those arguments included, but were not limited to, the following:

- CKFI had known that they were operating outside their exclusive territory but, with one exception, did nothing to stop them.
- Neither CKFI nor anyone else had informed them that the Fords' exclusive territory had been enlarged to include the new zip codes – zip codes in which the Middletons were doing business. Thus, they claimed, they were unaware that some of their activities amounted to encroachment.
- The Fords had stated that they had no intention of serving clients sent from a certain governmental referral source, so the Middletons' servicing of them was purportedly fair game. (The Fords denied having made the statement or even harboring such sentiments.)

None of the Middletons' arguments swayed the jurors, who returned a verdict for the

Fords on both counts.[1] As we had explained to the jury, CKFI's alleged knowledge of and failure to act upon the Middletons' violations of the Franchise Agreement were irrelevant to the Fords' claim for breach. In fact, the third party beneficiary doctrine was created specifically for a situation in which the party that contracted on behalf of the third party has relatively little incentive/inclination to enforce the third party's rights through litigation or otherwise. Through that doctrine, wronged parties like the Fords can protect themselves if their "benefactors" do not.

Similarly, the jury clearly rejected the Middletons' argument that their supposed ignorance of the Fords' enlarged territories excused their encroachment in the "new" exclusive regions. First, we noted the Middletons could have learned about the Fords' enlarged territory if they had simply sought prior written permission from CKFI as required by the Franchise Agreement. Their failure to do so, we argued, should not be rewarded. Second, our claim for breach of contract did not even *require* a showing of intent to encroach. We needed only to show (i) that the Middletons failed to comply with a contractual provision entitled to benefit the Fords, and (ii) that the Fords suffered damages as a result of that failure. (In contrast, our claim for wrongful interference with economic relations *did* require a showing of wrongful intent. In issuing a verdict for us on *that* count, the jury found that wrongful intent actually existed.)

Finally, the jury rejected the notion that the Fords' alleged expression of disinterest in servicing certain clients in their territory effectively gave the Middletons a proverbial "green light" to obtain business from those clients. It could be that the jury, which appeared find the Fords more credible, simply believed my clients' denial that they had ever made such a statement. The jury also might have – correctly – accepted our argument that, without more, such a statement would have been insufficient to constitute a waiver of my clients' right to exclusivity in their territories.

A number of lessons can be taken from *Ford v. Middleton*. First, if you desire in good faith to operate outside of your exclusive territory, follow the applicable Franchise Agreement and/or Operations Manual to the letter to ensure that (i) there are certain circumstances in which such operation is permissible, and (ii) you are following proper procedure to avoid unauthorized activities. Second, do not be lulled into a false sense of security by what may be a lenient enforcement policy by your franchisor. Your Franchise Agreement, like the Comfort Keepers Franchise Agreement, might just empower a victimized franchisee to fight its own litigation battles against you. Third, the fact that another franchisee might have neglected to – or decided not to – service certain customers within his/her territory does not necessarily entitle **you** to service those customers.

In short, avoid unauthorized encroachment at all costs. Not only is it the morally and ethically correct thing to do, but it is in your self interest.

[1] An appellate court upheld the judgment in 2011.